operate between <u>two</u> incumbent LECS to facilitate the service they provide in their respective, <u>mutually-exclusive</u> franchise areas.[60]

There is no indication that Congress intended to sweep within Section 251(c) agreements between non-competing incumbent LECS. To the contrary, the legislative history confirms that Congress intended to promote <u>competition</u> between incumbent LECs and <u>new entrants</u> within LEC exchanges.[61] It would not remotely advance this purpose to apply the requirements of Section 251(c) to neighboring

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[60]Interconnection arrangements between incumbent LECs and non-competing neighboring telephone companies ("NTC") vary by state, but generally address: extended area service; NTC-billed intraLATA toll services; provisioning and maintenance of access service; private line services; provisioning and maintenance of access services; interLATA and intraLATA billing services; intraLATA operator services; directory services; interstate "meet point" compensation agreements; SS7 and 800 database services; enhanced 911 services; and paging services. The contracts enable smaller, typically rural NTCs to provide full service to end users in their exchange territories. They do not enable larger, incumbent LECs and NTCs to compete by providing telephone exchange service or exchange access in the territory of the other carrier.

[61]<u>See</u>, <u>e.g.</u>, Joint Explanatory Statement at 117 ("New subsection 251(a) [of S. 652, which corresponds to Section 251(c)(2) of the Act] imposes a duty on local exchange carriers possessing market power in the provision of telephone exchange service or exchange access service <u>in a particular local area</u> to negotiate in good faith and to provide interconnection with other telecommunications carriers that have requested interconnection <u>for the purpose of providing telephone exchange service or exchange access service</u>") (emphasis added); <u>id.</u> at 120 ("Section 242(a)(1) [of the House amendment, which is generally reflected in Section 251(c) of the Act] sets out the specific requirements of openness and accessibility that apply to LECs <u>as competitors enter the local market</u> and seek access to, and interconnection with, the incumbent's network facilities") (emphasis added); <u>id.</u> ("Section 242(b)(1) [of the House amendment] describes the specific terms and conditions for interconnection, compensation, and equal access, <u>which are integral to a competing provider seeking to offer local telephone services over it own facilities</u>") (emphasis added).

LECs that do not compete with one another. The principal purpose of agreements with neighboring LECs is to promote universal service, not competition. That is not to say that such neighboring LECs cannot compete with one another or that, if they choose to do so, their agreements would not be governed by Section 251(c). The point is rather that existing arrangements between non-competing neighboring LECS fall outside the purview of Section 251(c).[62]

For essentially the same reasons, the reciprocal compensation requirement of Section 251(b)(5) does not apply to the "transport and termination of telecommunications" traffic between non-competing neighboring LECs. Section 251(b) sets out the minimum terms of interconnection that Congress deemed necessary to

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[62]This conclusion comports with the letter and spirit of other provisions of the Act. Under Section 251(f), rural telephone companies are exempt from the requirements of Section 251(c) until certain conditions are met. Many non-competing neighboring telephone companies would qualify for protection under this provision. Interpreting Section 251(c) to apply to interconnection agreements between incumbent LECs and NTCs (and thus to compel disclosure of these agreements to all other requesting telecommunications carriers under Section 252(i)) would undermine the purpose of Section 251(f) to shield all rural companies from competition absent certain conditions.

Such an interpretation would also undermine the purpose of Section 259, which governs infrastructure sharing. Section 259 permits a smaller telephone company that provides telephone exchange service and exchange access, in service areas in which it has been designated as an eligible telecommunications carrier for universal service purposes, to enjoy the economies of scale or scope that larger incumbent LECs enjoy. Infrastructure sharing arrangements are exempt from the approval process and availability requirements of Sections 252(a) and (i) because they do not provide for "common carrier services" under the 1934 Act. See 47 U.S.C. § 259(b)(3). Because interconnection arrangements between incumbent LECs and NTCs frequently cover matters falling within the scope of "infrastructure sharing," it would be inconsistent with Section 259 to subject them to the requirements of Sections 252(a) and (i).

facilitate competition within a local exchange market. Reciprocal compensation was one of those requirements. Thus, section 251(b)(5), read in context, requires reciprocal compensation for "transport and termination of telecommunications" of traffic between competing providers within a local exchange market. Traffic between non-competing neighboring LECs does not qualify and is therefore exempt from the reciprocal compensation requirement.

### 3. Resale Obligations

#### a. Statutory Language.

Under Section 251(c)(4), incumbent LECs must offer retail telecommunications services for resale at wholesale rates. The plan of the 1996 Act is that services sold at retail to end users ("finished" services) should be sold at a wholesale rate, defined by Section 252(d)(3) as the retail rate minus avoided cost.

#### b. Resale Service and Conditions.

The NPRM seeks comment on what limitations, if any, incumbent LECs should be permitted to impose with respect to services offered for resale under Section 251(c)(4), noting that the statute imposes on all LECs a duty not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on the resale of telecommunications services. See NPRM ¶ 174; 1996 Act §§ 251(b)(1), 251(c)(4)(B). The Commission initially has concluded that in view of "the pro-competitive thrust of the 1996 Act and the belief that restrictions and conditions are likely to be evidence of an exercise of market power," the range of permissible restrictions on resale should be "quite narrow." NPRM ¶ 175.

The issue, of course, is what the Commission means by "quite narrow." In Section 251(c)(4)(B), Congress recognized that certain kinds of arbitrage are not in the public interest. Specifically, where a telecommunications service is available at retail to only one category of subscribers, a State may prohibit the offering of such service by a reseller to a different category of subscribers. USTA believes that, as suggested by Congress, State commissions are in the best position to determine whether and when resale restrictions are not unreasonable or discriminatory. Rates and rate structures for retail service offerings of incumbent LECs historically have been products of important State and local public policy considerations, including universal service goals. Given this fact, reasonable restrictions on resale can serve pro-competitive ends.

Accordingly, if the Commission issues guidelines for states to follow in setting reasonable resale restrictions, USTA believes that each of the following limitations meets the statutory requirements of Section 251(c)(4)(B), is pro-competitive, and is fully consistent with the goals of the 1996 Act:

(1) **The resale obligation applies only to "telecommunications services."** While this point follows directly from the text of Section 251(c)(4)(A), Commission guidelines should make clear that service offerings that fall outside of the 1996 Act's transmission-based definition of "telecommunications service" need not be offered for resale by incumbent LECs, e.g., billing and collection services, enhanced white page listing, customer premises equipment, or inside wire.

(2) **States may prohibit cross-class selling of telecommunications services (e.g., residence to business).** As mentioned, Section 251(c)(4)(B) of the 1996 Act expressly recognizes this as a reasonable resale restriction, e.g., prohibiting the resale of cheaper residential telephone service to business customers.

(3) **States may prohibit the resale of promotional, discounted or special packaged offerings.** Promotional offerings are of limited time and duration. A tremendous disincentive would be created for incumbent LECs to offer promotions if they were automatically obligated to offer them to resellers, who are perfectly capable of creating their own packaging and pricing.[63]

(4) **States may prohibit the application of resale to market trials.** The purpose of market trials is to determine whether to offer a new service at retail, and such trials are inherently limited in time and scope. No resale obligation should be triggered until an incumbent LEC has begun offering a telecommunications service to the public on a permanent basis.

(5) **States may prohibit the resale of "grandfathered" services.** The 1996 Act did not remove the decisional ability of incumbent LECs either to offer or discontinue particular telecommunications services. To the extent a LEC decides to withdraw a service generally from the marketplace such that it is no longer available to the public, but continues to offer the service to a limited class of preexisting customers on a "grandfathered" basis, the service should no longer be required to be made available to resellers.

(6) **States may prohibit the application of resale to customer-specific contract arrangements offered to**

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[63]Indeed, it is doubtful that a promotional offering even constitutes a separate "telecommunications service" that LECs could be required to offer for resale. The offering of a telecommunications service at a distinct price is not itself a distinct "service." Otherwise, Section 253(a) -- which prohibits states from prohibiting any entity from offering any telecommunications service -- would altogether preclude states from regulating prices. Complete pricing flexibility -- the ability to offer services at different prices (i.e., different services) -- would be mandated by the Act.

> **meet competitive bids.** The application of the resale obligation in such circumstances would be inappropriate, since such discounts are not generally made available to the public and instead are part of customer-specific business arrangements.

Finally, the Commission should recognize that the resale obligation as contemplated by the 1996 Act is not and should not be a permanent construct. Resale is envisioned under the statute as a method for new entrants to establish a presence in the local exchange market while they build out their own facilities. Once facilities based competition is established, the justification for the resale obligation disappears.

c. Pricing of Wholesale Services

(1) Statutory Language

Section 252(d)(3) requires that wholesale rates be set on the basis of retail rates less the costs of marketing, billing, collection and other costs that the LEC avoids when a competitor rather than the LEC itself sells the service to end users. To the extent that the Commission addresses resale-related price issues, there are several aspects of this "avoided cost" standard that the Commission should clarify.

(2) Discussion

Although a LEC may reduce costs when it reduces retail output, it may incur other costs to provide a service at wholesale. Those wholesaling costs should be included in the wholesale rate to assure that proper price signals are sent to wholesale purchasers. The Commission has already noted that any reduction off retail rates should be "offset by any portion of those expenses that

[LECs] incur in the provision of wholesale services" (NPRM ¶ 180). Section 251(c)(4) should thus be interpreted as requiring discount of only net avoided costs.

Moreover, to preserve the efficient properties of the net-avoided-cost standard, avoided costs should not include a pro-rata share of "general overhead." Overhead costs are fixed costs that do not drop continuously with retail service quantity. The LEC will incur the same common costs, and allowing overhead to be proportionally reduced by the volume of resold services will be confiscatory and contrary to the terms of the Act. Therefore, any deduction for avoided costs should not include overheads.

The Commission should also recognize that some LEC services are currently priced below even LRIC because of regulation. In this situation, wholesale rates set below retail rates will cause economic inefficiency. Hausman Aff. ¶ 24. To the extent LECs are nonetheless required to permit resale of below-cost services, most notably residential basic exchange service, any associated universal service funding should continue to go to the LEC. The Commission should recognize that these below-cost rates are a compelling reason to resolve the broader universal service issues as promptly as possible. Indeed, selling such below-cost services at a further wholesale discount to competitors will hinder the growth of facilities-based competition. Id. ¶¶ 24-25.

Finally, because the amount of costs avoided may differ across services and firms, the Commission should permit discount rates to vary across those services and firms. Accordingly, the Commission should not mandate a uniform discount as a proxy for avoided costs. No "administrative complexity" need result from different discounts for different services so long as the process of determining the appropriate discount is left to negotiation by the parties subject to state review, as the Act contemplates.[64]

(3) Relationship to Other Pricing Standards

The standards for wholesale rates and rates for unbundled network elements are distinct: wholesale rates are based on retail rates minus avoided costs, 1996 Act § 252(d)(3), whereas rates for unbundled elements are "based on cost" and may include a "reasonable profit," id. § 252(d)(1). The rates have different starting points and different ending points. They are simply not the same, and cannot be made the same without doing violence to the language of the statute. Accordingly, in order to preserve the statutory distinction and the independent effects of Sections 252(d)(1) and 252(d)(3), the Commission should adopt regulations that prevent entrants from engaging in arbitrage between the resale and the interconnection and unbundling provisions of the 1996 Act.

(a) Resale rates should apply only to individual services in the form in which they are sold at retail. An incumbent LEC has a duty to offer for resale only services that the LEC "provides at retail to subscribers who are not telecommunications carriers." 1996 Act § 251(c)(4). Thus, a requesting carrier may not design

[64]Some LECs might well choose to give uniform discounts because their billing systems will not be able to handle anything else. But such uniformity should not be mandated by the Commission.

its own service and demand that the LEC provide that service at wholesale rates.

(b) No evasion of the resale standard should be permitted. Conversely, the Commission should prohibit entrants from purchasing network elements separately and reassembling them into retail services that are provided solely over the LEC's network. Such a strategy would allow entrants to evade the Act's resale provision whenever that proved advantageous. For example, a new entrant providing its own loops might acquire access to the LEC's switch on an unbundled basis. Or, a new entrant with switches might acquire unbundled loops from a LEC. But, if the distinction between resale and unbundled elements is to be maintained, a new entrant cannot acquire unbundled loops and access to the unbundled switch and then simply patch them together to provide a retail service. That service would have to be obtained from the LEC at wholesale rates under Section 252(d)(3). Nor may a requesting carrier purchase unbundled vertical services (such as Caller ID or call waiting) under the pricing standards of Section 252(d)(1). Since the vertical services are retail communications services, the requesting carrier must purchase them at the wholesale rates of Section 252(d)(3).

Furthermore, if network element rates are improperly set by regulators such that they fail to cover the LECs' total costs, reassembly of elements into retail service packages would allow entrants to "compete" by bearing only incremental costs of the network, thereby creating perverse incentives for incumbent LECs and undermining the Act's purpose of promoting facilities-based competition.

(c) Imputation rules are inappropriate. "Imputation rules" that link cumulative rates for unbundled elements to retail rates should not be adopted. See NPRM ¶¶ 184-187. Congress expressly tied wholesale rates to retail rates, not to the costs of the underlying service elements. There is no requirement in the statute that retail rates be based on cost, and some retail rates are actually below cost. So there is no reason to expect that the total costs of each unbundled service element, when combined together, will bear any relation to the retail rate set by state regulators.

Indeed, since some retail rates are below cost (for example, local residential service), an imputation rule would often force LECs to sell unbundled elements at well below cost. In such cases, an imputation rule will either force the LEC to subsidize new entrants (which is confiscatory) or force the states to raise the allowable retail rates. The FCC cannot impose the provision of below-cost unbundled network elements by mandating imputation rules without affirmatively and completely addressing the deficiency that would be created with respect to incumbent LEC total cost recovery.

4. Public Notice of Technical Changes.

USTA will deal with this issue in its comments due May 20th.

### C. Obligations of LECs

#### 1. Resale

Section 251(b)(1) prohibits all LECs from imposing unreasonable restrictions or limitations on resale. To the extent that the Commission promulgates a guideline with respect to this obligation, USTA recommends that the Commission simply codify the statutory requirement that LECs not impose unreasonable or discriminatory conditions or limitations on the resale of telecommunications services unless sanctioned by a state in accordance with the 1996 Act. The guideline should clarify once again that there are various instances where the resale obligation can and should be limited by the States. See supra pp. 70-73.

#### 2-4. Number Portability/Dialing Parity/Access to Rights of Way

USTA will deal with these issues in its comments due May 20th.

#### 5. Reciprocal Compensation

a. Statutory Language

To qualify as "just and reasonable," reciprocal compensation arrangements for the transport and termination of calls must provide for the mutual recovery of costs, determined on the basis of "a reasonable approximation of the additional costs of terminating such calls." 1996 Act § 252(d)(2)(ii). It is critical to note that this language does not set a price ceiling. At the very least, the statute appears to require (and every arbitrated agreement must "provide" for), a recovery of "the additional costs of terminating such calls." The Act does not, however, restrict recovery to this amount.[65] Although the reference to "additional costs" could be read to incorporate a LRIC-based methodology for determining a price floor, it does not preclude additional recovery for joint and common costs or embedded costs or even for a reasonable profit. The floor simply provides low-side protection for both parties.

b. State Activity

Subject to this price floor, state commissions have considerable discretion in implementing reciprocal compensation agreements. Policies designed to facilitate and encourage rapid negotiation, such as Pennsylvania's escrow arrangement, may reasonably coexist with the Act's requirements so long as final allocation of funds allows costs to be recovered by each party. State policies that set below-cost rates or mandate a bill-and-keep arrangement are, however, incompatible with the Act. As explained more fully below, bill-and-keep arrangements that preclude reciprocal compensation can only exist upon voluntary waiver of the mutual recovery requirement. 1996 Act § 252(d)(2)(B)(i). Waiver is the privilege of parties, not regulators. Accordingly, mandated bill-and-keep rules are incompatible with the Act and they must be abandoned in Washington and other states that have such regulations in place.

[65]By contrast, Section 252(d)(1) requires charges to be "based on" cost. Section 252(d)(2) merely requires the recovery of additional costs. It does not state that the actual charges must be based on those costs.

c. <u>Definition of Transport and Termination</u>

USTA has already explained why section 251(b)(5) applies to interconnection agreements between a LEC and a CMRS provider offering "telephone exchange service" within the LEC's service area. <u>See</u> pp. 66-67, <u>supra</u>. USTA has further explained why section 251(b)(5) does not apply to agreements between neighboring LECs, neither of which competes with the other. <u>See</u> <u>supra</u> pp. 67-70.

The Commission also seeks comment on whether "transport" and "termination" should be priced separately and whether it should require states to price facilities dedicated to an interconnecting carrier, such as the transport links, on a flat-rated basis. <u>NPRM</u> ¶ 231. In our view, the links for interconnection are provided under section 251(c)(2) and the corresponding pricing standards of section 252(d)(1).[66] Those dedicated links, insofar as they are not traffic sensitive, should be priced on a flat-rate basis. Section 252(d)(2) covers, as a single unit, the carriage and termination of traffic from the first point of switching, to which the dedicated links are connected, to the final destination. This carriage and termination roughly corresponds to the way switched access works and (since it uses non-dedicated facilities, such as the LEC's

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[66]Section 251(c)(2)(A) covers interconnection, inter alia, "for the transmission and routing of telephone exchange service," which plainly encompasses the transport and termination of calls that originate on a rival's network. Thus, the physical interconnection of the two networks is established under this section. The reciprocal compensation provision, by contrast, focuses on the "additional costs" of taking traffic from one carrier and terminating it on the network of the other. It assumes the physical interconnection and focuses on the traffic.

switch) is traffic sensitive and should be priced on a per-minute of use basis.

d. Rate Levels

A strict separation of flat-rate "interconnection" from usage-based "transport and termination" should resolve the Commission's concerns about "the use of different pricing rules for the different categories" of services mandated by the 1996 Act. Reciprocal compensation pursuant to Section 252(d)(2) arises whenever the customer of one local carrier attempts to complete a call to the customer of a competing local carrier. The interconnection between the two networks is handled separately under Section 252(d)(1). And if the new entrant needs to piece-out parts of its own network, it may buy unbundled elements (such as local loops or ports) to do so, again under Section 252(d)(1). But if that new entrant wants to terminate a call from its customer to the customer of the incumbent LEC, it must still pay the reciprocal compensation charge, in addition to any charges for unbundled elements that it has purchased.

The lines of distinction here should not be difficult to police. Moreover, the difference between the pricing standards of Section 252(d)(1) and (d)(2) should not be exaggerated. Even if Section 252(d)(2) could be read to set a floor based on a "reasonable approximation" of LRIC, it allows rates to rise above that floor, just as economic theory dictates they should be. Above that floor, the Commission should leave the matter to private negotiations subject to arbitration by the states. Because each party to a reciprocal compensation arrangement is both a buyer from, and a seller to, the other party, greater flexibility within the bounds of Section 252(d)(2) will facilitate negotiation. The Act recognizes this fact in the non-preclusion provisions of Section 252(d)(2)(B)(i), and in the prohibition on rate regulation proceedings in Section 252(d)(2)(B)(ii).

e. Symmetry

The Act requires, at a minimum, the "mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network" of calls that originate on the other carrier's network. 1996 Act § 252(d)(2)(A)(i). This language strongly implies that "each carrier" should recover its own costs. And one carrier's costs are likely to be quite different from another carrier's costs. A new entrant, for example, will be constructing its network from scratch. Accordingly, it can build a network that corresponds much more closely to the forward-looking ideal of TSLRIC plus joint and common costs. The LECs, by contrast, will also have substantial embedded costs that must be recovered. Because actual cost-structures will vary, any FCC role in setting a symmetrical rate will merely distort the market by interfering with efficient cost-based price signals. Such matters should be left to negotiation and state arbitration, not resolved by Commission fiat.

f. Bill-and-Keep Arrangements

Mandatory bill-and-keep arrangements are flatly inconsistent with the language and structure of the Act. See USTA Comments at

15. Section 252(d)(2)(A) requires "the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination" of calls that originate on the other's network," determined on the basis "of a reasonable approximation of the additional cost of terminating such calls." Put simply, this section requires a recovery of costs. Bill-and-keep arrangements permit no cost recovery from the originating carrier.

Under the plain terms of the Act, bill-and-keep arrangements are permissible in only one limited circumstance: where parties, through the offsetting of reciprocal obligations, voluntarily agree to "waive mutual recovery." 1996 Act § 252(d)(2)(B)(i). According to the Commission, this language is not necessary to prevent a state commission from rejecting a voluntary agreement containing a bill-and-keep arrangement. State commissions may only reject an agreement that discriminates against non-party telecommunications carriers or that is inconsistent with the public interest, convenience, and necessity. NPRM ¶ 243. Thus, the Commission speculates, the language "may be intended to authorize the states to impose bill-and-keep arrangements in arbitration." Id.

This argument ignores the strong wording of Section 252(d)(2)(A), which requires -- in no uncertain terms -- that state commissions provide for mutual compensation based on cost. Section 252(d)(2)(B)(i) makes clear that this requirement does not prohibit parties from voluntarily agreeing to waive mutual recovery, but it does not permit the states simply to ignore the requirement that costs be recovered.[67] If this language were read to authorize state commissions to impose bill-and-keep arrangements in arbitration, even in the absence of equal traffic volumes, Section 252(d)(2)(A) would essentially be rendered meaningless.[68]

Finally, mandatory bill-and-keep arrangements would run afoul of the Takings Clause to the extent they require a LEC to incur the costs of transporting and terminating another carrier's traffic without "just compensation."[69] The Commission must have a "clear warrant" to adopt an interpretation of a statute that effectuates a taking.[70] As stated above, the Commission not only lacks a clear warrant to mandate bill and keep under the Act, but lacks <u>any</u> authority to do so.

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[67]This scenario is not far-fetched. Many states have adopted bill-and-keep arrangements on an interim basis largely because, in the Commission's words, such arrangements are "quickly established and easily administered." <u>NPRM</u> at ¶ 241. The Commission's interpretation would provide state commissions the leeway (and the incentive) to turn an interim solution into a permanent disregard for the clear congressional mandate to establish mutual recovery.

[68]Even if the Act is tenuously construed to allow regulators to mandate bill and keep where reciprocal obligations fully offset, it is impossible in practice for regulators to establish such a rule without measuring termination and transport costs for the particular carriers and traffic at issue. Yet such measurement is barred by Section 252(d)(2)(B)(ii). Moreover, even where costs do appear to offset at first, bill and keep is still economically irrational because it creates an incentive for new entrants to sign up customers with predominantly originating traffic. Costs would quickly fall out of balance.

[69]<u>See generally</u>, Ex Parte Letter of Richard Epstein to William Kennard, CC Dkt. No. 95-185 (May 15, 1996).

[70]<u>See</u> <u>Bell Atlantic Tel. Cos. v. FCC</u>, 24 F.3d at 1445; <u>see also</u> <u>Rust v. Sullivan</u>, 500 U.S. at 190-91.

g. Other Possible Standards

If the Commission adopts a "presumptive uniform per-minute interconnection rate" (NPRM ¶ 244), it must ensure that carriers can depart from that rate in appropriate circumstances. Otherwise, such a rate would be inefficient, because it would ignore variations in actual costs. Some carriers would be undercompensated by such a scheme. As a result, any proxy should serve only as a presumptively lawful rate.

If, for administrative convenience, the Commission does decide to adopt a presumptive standard, the proper level would be the same as for switched access charges (which will vary depending upon whether interconnection is at the local end office or the tandem). As already discussed, the CCLC and the RIC should be included in those charges, unless the Commission maintains a strict line of separation between IXC access and the local transport and termination contemplated by the Act. See supra pp. 51-52. Also, it must be stressed again, that no particular price levels will be appropriate for all LECs. Small and mid-size LECs in particular will have greater costs and must, therefore, be able to depart from any nationwide averages.

**D. Duties Imposed on Telecommunications Carriers**

USTA has no additional comments on this issue.

**E. Number Administration**

USTA will deal with this issue in its comments due May 20th.

### F. Exemptions, Suspensions, Modifications

The Commission has tentatively concluded that the states alone have authority under Section 251(f) to make determinations regarding the termination of the rural telephone company exemption from the requirements of Section 251(c). That is true, so far as it goes. Section 251(f)(1)(A) provides that Section 251(c) shall not apply to a rural telephone company until

> (i) such company has received a bona fide request for interconnection services, or network elements, and (ii) the State commission determines (under subparagraph (B)) that such a request is not unduly economically burdensome, is technically feasible, and is consistent with section 254 (other than subsection (b)(7) and (c)(1)(D) thereof).

1996 Act § 251(f)(1)(A) (emphasis added). Section 251(f)(1)(B) -- entitled "State Termination of Exemption and Implementation Schedule" (emphasis added) -- directs the state commission to "conduct an inquiry for the purpose of determining whether to terminate the exemption under subparagraph (A)" and to terminate the exemption within 120 days of receiving notice of a bona fide request that meets the criteria listed in subparagraph (A). Finally, Section 251(f)(1)(B) directs the state commission to establish an implementation schedule for compliance with the request.

The language of Section 251(f) thus leaves the exemption termination process to the states. This makes sense, since only the states will be intimately familiar with the ability of their rural LECs to comply with particular interconnection requests under Section 251(c). It should be noted, however, that Section 251(f) applies only to a state's determination of a specific company's exemption weighed against the merits of a bona fide request it has received. Statewide elimination of exemptions for all companies is inconsistent with this legislative language and, to the extent such measure have been enacted, they cannot be allowed to stand.

Moreover, the Commission can, and should, provide guidance to the states on what constitutes a "bona fide request for interconnection, services, or network elements." Congress rightly expressed considerable solicitude for the concerns of smaller LECs. These companies could easily be overwhelmed by costly interconnection and unbundling requests that the larger LECs can take in stride. The Commission, therefore, needs to provide guidelines to the states so that undue economic and technical burdens are not imposed on smaller LECs.[71]

Specifically, the Commission should establish the following basic guidelines for a bona fide request:

- The requesting carrier must offer service within one year following agreement or arbitration, and the agreement must provide for a one-year minimum service period (with the states free to require a longer service period). This requirement will ensure that rural LECs are able to recoup the costs of the agreement and that requesting carriers are in earnest.

- The points where interconnection is sought must be identified, network components and quantities must be specified, and the date when interconnection is desired must be given.

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[71]Sections 251 and 252 delegate most implementation responsibilities to the states. But the Commission has not been reticent, in its NPRM, in expressing an intention to guide the states by explicating the terms of these two provisions. The Commission should follow a consistent course with Section 251(f). Such guidance will ensure a uniformity of interpretation and implementation by the states in keeping with congressional intent.

- The LEC must be able to recover any investment required and/or expenses incurred to satisfy an interconnection or unbundling request. Thus, the requesting carrier must be willing to pay charges sufficient to compensate the LEC for all costs incurred in fulfilling the terms of the interconnection agreement, and those charges must be reflected in the agreement or arbitration order. The states, moreover, may require additional assurances, such as deposits or performance bonds.

Only if these guidelines are followed by the states will Congress's desire to protect smaller LECs be fulfilled.

The Commission has also tentatively concluded that the states alone have authority to make determinations as to whether a local exchange carrier with fewer than two percent of the nation's subscriber lines installed in the aggregate nationwide should be granted a suspension or modification of the application of the requirements of Section 251(b) or (c). The Commission seeks comment on whether standards should be established to assist the states in satisfying their obligation under this provision.

This provision was a well thought out and thoroughly considered section of the Act. By including it, Congress acknowledged significant differences in size, financial ability, resources and economies of scope and scale between small/mid-size LECs and large LECs. The legislative history of this provision indicates that Congress intended to provide a level playing field for small and mid-size LECs, particularly when competing for local service customers against significantly larger national or global telecommunications companies with significantly greater technological and financial resources. The Congressional intent clearly was that this provision apply to all LECs with less than two percent of the nation's access lines.

Small and mid-size LECs can effectively compete for the subscribers they have so faithfully served for so many years, provided they are given sufficient time and reasonable accommodations recognized as needed by Congress. By allowing the two percent suspensions and modifications clause in the Act, Congress provided for a transition for small and mid-size companies from the franchised monopoly to the competitive world without compromising the intent of the Act.

It is both appropriate and necessary that the Commission set guidelines for states to follow in carrying out their duties under this section of the Act. The overall intent of the Act is to provide for competition in the local telecommunications market to offer increased choice and potentially lower prices to the consumer. It was not the intent of Congress to accomplish these goals at the expense of small and mid-size LECs and their customers.

The passage of the Act offers additional opportunities for many new market entrants. Specifically, it breaks down regulatory barriers and opens up local telephone, long-distance service and cable television to competition, thereby eliminating many of the restrictions that have prevented telephone companies, long-distance carriers and cable and utility companies from competing with each other. IXCs, cable television companies, RBOCs, and new entrants in the telecommunications marketplace all stand to gain a great deal from provisions in the new Act. Specifically, the Act removes the ban that prohibited the RBOCs from entering the interstate market that was essentially dominated by AT&T, MCI and Sprint. Those dominant interexchange carriers can now enter every local market, even if they were previously foreclosed by state law. In addition, the new Act benefits new entrants by requiring incumbent LECs to offer interconnection, unbundled elements, resale and access to public rights of way, which requires them to open the local telephone business to new competitors.

However, the 1996 Act does not offer any significant benefit to small and mid-size LECs. Congress recognized this fact and allowed some latitude for small and mid-size LECs by including the suspensions and modification section. Congress intended to give these smaller companies a fair chance in the new marketplace by establishing a level playing field.

The ultimate decision for approval of the suspensions and modifications properly belongs with the states. Because each petition is likely to vary based on the specific circumstances surrounding the particular LEC, only the states will be close enough to the situation to appropriately determine if suspension or modification satisfies the criteria in the Act. However, there should be some consistency in application of the suspensions and modifications among states. Consistency is important for small and mid-size LECs which may operate in more than one state so that they do not have to meet different requirements in each state. To add that consistency, USTA recommends that the Commission adopt standards to assist the states when ruling on petitions of suspension or modification under Section 251(f)(2).

In general, the Commission's guidelines should focus on the concept of cost causation assuring the LECs' full cost recovery. Small and mid-size LECs are likely to lose some customers and associated revenues to new market entrants. These losses should not be magnified by ignoring legitimate requests for consideration under the two percent suspensions and modifications. In no event should a small or mid-size LEC be made to provide a new entrant any unbundled network element or resold service where the LEC is not permitted to recover its total cost. Guidelines should be established to allow a suspension or modification in cases where the wholesale rate would be less than the cost of providing the service. Suspensions or modifications should also be allowed when a LEC would incur expenses to establish unbundled elements where the LEC would be at risk to recover the total cost of providing the interconnection requested. This is particularly important to avoid having the LEC subsidize the potentially larger and financially sound new entrant by providing unbundled elements or wholesale services below cost. In short, the Commission should establish guidelines that encourage the states to grant waivers for suspensions or modifications until both federal and state Universal Service issues are resolved, all implicit subsidies are eliminated, and rates are deaveraged and rebalanced.

The FCC should further establish guidelines for the states which would at least minimally recognize the following:

(1) Adverse economic impact on users of telecommunications services may be inferred from a situation where a small or mid-size LEC cannot recover its total cost, thereby providing a disincentive for a small or mid-size LEC to make further investment in the local area. Other examples include situations where LECs have difficulty raising sufficient investment capital, an where the remaining customers of small and mid-size LECs would likely bear an increase in rates or a reduction in service to cover a shortfall or subsidy to a new entrant.

(2) Unduly economically burdensome conditions may be established from any showing that the LEC is not able to recover its total cost. This would include items provided below cost and interconnection requests that do not satisfy the bona fide request process outlined above. When considering the economic burden on the small or mid-size LECs, states should assure the LEC of recovery of any investment required or expenses incurred to satisfy an interconnection or unbundling request. Thus, the requesting carrier must be willing to compensate the LEC for expenses incurred in satisfying the terms of the interconnection agreement, including those incurred in developing costs and rates, modifying support systems, and other relevant terms. Basing guidelines upon accepted cost causation principles, the requesting carrier must pay these charges even if the decision is made not to place an order. The small or mid-size LEC must not be "at risk" for the expenses incurred at the whim of a requesting carrier. The state may require additional assurances, advance payments, deposits or performance bonds, if necessary.

(3) Technical feasibility should include an acknowledgement of the limited resources and lack of economies of scale or smaller companies. Moreover, any requested interconnection arrangement must have been previously implemented by a large LEC. Even if the interconnection has been successfully accomplished at another installation, consideration should still be given to the cost/benefit of this specific interconnection in light of the lack of economies of scale and scope, and resources of the small or mid-size company.

Guidelines should also encourage the states to find that the following situations are consistent with the public interest, convenience and necessity:

(1) Consistent with the intent of the Act to provide facilities-based local service competition, any